IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 152

EVERIT B. TERHUNE, *et al.*, Executors under the will of WILLIAM L. TERHUNE,

Petitioners,

v.

WILLIAM M. WELCH, Collector.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF OF *AMICI CURIAE*

The Circuit Court of Appeals (126 Fed. (2d) 695), reversing the District Court (39 F. Supp. 430), has decided an important question of federal law which has not been, but should be, definitely settled by this Court, and has decided a federal question in a way probably in conflict with the principles of applicable decisions of this Court.

The decedent in 1929 transferred property to three trustees, of whom he was one, in trust for himself for life with remainder to his second wife and his children and their issue. As a result of her divorce from the decedent, the second wife's interest in the trust terminated before his death. The trust could be amended by consent of the surviving trustees and of the decedent's surviving children. He died on February 23, 1936. The Circuit Court held that

because of the power of amendment in the trustees and the principal beneficiaries the trust corpus was subject to inclusion in the gross estate for estate tax purposes under Section 302 (d) of the Revenue Act of 1926.

The Circuit Court reached its conclusion by construing Section 302 (d) as though it were in force as subsequently materially modified by the Revenue Act of 1936 at the time of the creation of the trusts and at the date of the decedent's death; by disregarding any difference between the capacity of the decedent as settlor and his relationship to the trust as trustee or beneficiary; by ignoring the limitations laid down in *Helvering* v. *City Bank Farmers Trust Co.* (296 U. S. 85) on the adoption by Congress of measures for the prevention of tax avoidance; by failing to consider the substantial similarity of the situation in *Helvering* v. *Helmholz* (296 U. S. 93); and by erroneously assuming that Congress had interpreted Section 302 (d) of the 1926 Act, before amendment in 1936, as covering a power exercisable by the decedent only as a trustee. The Circuit Court cited the decisions of this Court in *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85; *Reinecke* v. *Smith*, 289 U. S. 172; and *White* v. *Poor*, 296 U. S. 98; and we believe misconstrued them, thereby confusing and confounding the construction of Section 302 (d) as in force prior to the 1936 Act and as still applicable to many trusts created prior to the 1936 Act.

In their petition and brief the attorneys for the petitioner have assigned and argued the important questions involved in their application. This brief will attempt to indicate additional reasons why these questions are entitled to consideration and decision by this Court.

Statute

Prior to 1924 the Revenue Acts of 1916 (Section 202(b)), 1918 (Section 402 (c)) and 1921 (Section 402 (c)) merely provided for inclusion in the gross estate of property with respect to which the decedent had made a transfer, or with respect to which he had created a trust, "intended to take effect in possession or enjoyment at or after his death".

The provision of the estate tax statute commonly known as Section 302 (d) was first enacted in the Revenue Act of 1924. It appeared in the Revenue Act of 1926 as follows:

> SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated— . . .
>
> (d) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, . . .

The only change from the 1924 Act was the substitution of the phrase, "by trust or otherwise," for the clause, "or with respect to which he has at any time created a trust." Section 302 was amended by the Joint Resolution of March 3, 1931, by Section 803 of the Revenue Act of 1932, and by Section 401 of the Revenue Act of 1934, but not as respects the above provision.

Section 805 of the Revenue Act of 1936 provided:

> SEC. 805. ESTATE TAXES—REVOCABLE TRANSFERS.
>
> (a) Section 302 (d) (1) of the Revenue Act of 1926, as amended, is amended to read as follows:

"(d) (1) To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona-fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, . . ."

(b) Except in the case of transfers made after the date of the enactment of this Act, no interest of the decedent of which he has made a transfer shall be included in the gross estate under such section 302 (d) (1) unless it was includible under such section before its amendment by this section.

Section 811 of the Internal Revenue Code, corresponding with old Section 302, provides:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—. . .

(d) REVOCABLE TRANSFERS—

(1) TRANSFERS AFTER JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona-fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercis-

able) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, . . .

(2) TRANSFERS ON OR PRIOR TO JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, . . . Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph; . . .

Argument

As appears above, there were three stages of the estate tax statute here pertinent, applicable respectively (1) to the period prior to enactment of the Revenue Act of 1924; (2) to the period between 1924 and the date of the enactment of the Revenue Act of 1936, June 22, 1936; and (3) to the period after June 22, 1936. In ascertaining the application of each statute the date of the transfer and not the date of death is determinative.

(1) As to trusts created prior to 1924, it is clear that the reservation of a power of amendment in the settlor conditioned upon consent of beneficiaries does not subject the trust corpus to inclusion in the gross estate.

In *Reinecke* v. *Northern Trust Company*, 278 U. S. 339, seven trusts had been created between 1903 and 1919 by the decedent, who died in 1922, by the terms of two of which a

power of revocation of the trusts was reserved to the settlor alone and by the terms of the remaining five of which a power to alter, change or modify the trust was reserved to the settlor with the concurrence of the single beneficiary or of a majority of the beneficiaries. The Court held that under Section 402 (c) of the Revenue Act of 1921 the first two trusts were subject to inclusion in the gross estate, but that the other five trusts had not been intended to take effect in possession or enjoyment at or after the decedent's death. As to the latter trusts, the Court said in part (p. 346):

> "Since the power to revoke or alter was dependent on the consent of the one entitled to the beneficial, and consequently adverse, interest, the trust, for all practical purposes, had passed as completely from any control by decedent which might inure to his own benefit as if the gift had been absolute.
>
> Nor did the reserved powers of management of the trusts save to decedent any control over the economic benefits or the enjoyment of the property. He would equally have reserved all these powers and others had he made himself the trustee, but the transfer would not for that reason have been incomplete."

(2) The effect of the 1924 amendment initiating the second stage of the statute was to subject to estate tax trusts in which the power of amendment existed in the decedent "in conjunction with any person". The scope of this extension was considered by the Court in 1935 for the first time in several cases.

In *Helvering* v. *City Bank Farmers Trust Company*, 296 U. S. 85, the question was whether or not Section 302 (d) of the Revenue Act of 1926 was applicable to a trust created in 1930, where the trust deed contained the reserva-

tion of a right in the settlor to modify, alter or revoke it with the written consent of the trustee, a trust company, and her husband, a beneficiary of the trust. The Court pointed out that the purpose of Congress in adding clause (d) by the 1924 Act "was to prevent avoidance of the tax by the device of joining with the grantor in the exercise of the power of revocation someone who he believed would comply with his wishes", and that "Congress may adopt a measure reasonably calculated to prevent avoidance of a tax"; but that "if the means are unnecessary or inappropriate to the proposed end, are unreasonably harsh or oppressive, when viewed in the light of the expected benefit, or arbitrarily ignore recognized rights to enjoy or to convey individual property, the guaranty of due process is infringed". The Court concluded:

> "In view of the evident purpose of Congress we find nothing unreasonable or arbitrary in the provisions of § 302 (d) of the Revenue Act of 1926 as applied in the circumstances of this case."

In *Helvering* v. *Helmholz,* 296 U. S. 93, consideration was given to the application of Section 302 (d) of the Revenue Act of 1926 in the case of a trust created in 1918 by a settlor, who was also a beneficiary, where the trust deed provided for termination of the trust, among other things, upon delivery to the trustee of a written instrument signed by all the then beneficiaries other than testamentary appointees declaring said trust term at an end. The Court held that, since under general law all parties in interest might terminate a trust, the questioned clause added nothing to the rights which existed without it, and further that, since the trust was created prior to the enactment of Section 302 (d), its retroactive operation would violate the Fifth Amendment.

In *White* v. *Poor,* 296 U. S. 98, the decedent, who died in 1931, created a trust, of which she was a life beneficiary, with herself and two other individuals as trustees, the trust deed providing that the trust might be terminated at any time by the person or persons who should then be trustees thereunder. "No power was reserved by Mrs. Sargent to modify the terms of the trust, and the recited power was never exercised." In 1920 Mrs. Sargent resigned as trustee and a successor was appointed by the remaining trustees to fill the vacancy, pursuant to the terms of the trust deed, and in 1921 the successor trustee resigned and the settlor was appointed to fill the vacancy. The Court remarked that the declaration of trust, technically speaking, contained no power to revoke, alter or amend the trust, what the instrument did being to make it possible for the trustees acting jointly to terminate the trust at any time, and that by her appointment as trustee in 1921 she acquired any power for the future solely by virtue of the action of the other trustees and the beneficiaries and "not in any sense by virtue of any power reserved to herself as settlor in the original declaration of trust". The Court concluded "that neither technically nor in substance does the power to terminate as it existed from 1921 to the date of Mrs. Sargent's death fall within Section 302 (d)".

Two other cases decided at the same time, involving the consequences of a possibility of reversion in the settlor, have since been overruled on that point by *Helvering* v. *Hallock,* 309 U. S. 106. In one of these, *Helvering* v. *St. Louis Union Trust Company,* 296 U. S. 39, the trust deed provided that the trustee had discretionary power to terminate the trust whenever the trustee might deem it wise to do so, but this provision was not regarded as material in either the majority or minority opinions of the Court. *Cf. Herzog* v. *Commissioner,* 116 Fed. (2d) 591, 595. In

the other, *Becker* v. *St. Louis Union Trust Company,* 296 U. S. 48, in the course of its discussion the Court made the following statement not affected by the subsequent reversal of its position on the main issue (p. 50):

> "By the declaration of trust here under review, the legal title, possession and control of the trust estate passed irrevocably from the grantor as an individual to himself as trustee. The effect is no different than if the trustee had been another person. Cf. Reinecke *v.* Northern Trust Co. 278 U. S. 339, 346."

(3) The ambiguity in the 1924 and 1926 Acts, to which the Court had adverted in *White* v. *Poor,* and the desire of Congress to secure additional revenue from the inclusion of gifts in trust in the gross estate, evidently impelled the Treasury Department to urge upon Congress amendments to Section 302 (d) broadening its scope. The Revenue Bill of 1936 (H. R. 12395) as introduced in the House of Representatives on April 21, 1936, and subsequently passed by the House, and as reported by the Senate Committee on Finance on June 1, 1936, contained no modification of Section 302 (d). As amended on the floor of the Senate and passed by the Senate on June 5, 1936, the bill contained a provision as follows:

> SEC. 807. ESTATE TAXES—REVOCABLE TRANSFERS.
>
> (a) Section 302 (d) (1) of the Revenue Act of 1926, as amended, is amended to read as follows:
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> "(d) (1) To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona-fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through

> the exercise of a power (whether created at the time of such transfer or thereafter arising from any source, and whether exercisable in an individual or representative capacity) by the decedent alone or by the decedent in conjunction with any other person, to alter, amend, revoke, or terminate, . . ."
>
> (b) The amendment by subsection (a) of this section shall not apply to decedents dying prior to the date of the enactment of this Act.

In Conference Committee the House and Senate agreed on a modified provision, which was enacted as Section 805 of the Revenue Act of 1936, set forth above at page 5. (Conference Report, 74th Congress, 2d Session, Report No. 3068, page 19.)

A separate bill (H. R. 12793) to amend the internal revenue laws had been introduced in the House on May 20, 1936, but was not passed. Section 206 (a) of that bill proposed to amend Section 302 (d) along the lines of the original Senate amendment, but also subjecting to inclusion in the gross estate trusts in which someone exclusive of the settlor had the power of amendment. As to these abortive provisions, the Committee on Ways and Means in its report dated May 26, 1936 (74th Congress, 2d Session, Report No. 2818), at pages 9 and 10, commented as set forth in the appendix to the respondent's brief, at pages 11-13, and added:

> "The foregoing amendments to the estate tax laws are of great importance from a revenue standpoint. The total estate tax estimated for the present fiscal year will probably aggregate $200,000,000. Transfers will account for some $40,000,000 in taxes, against which it is estimated there will be credited gift taxes paid with respect to such transfers, of approximately $20,000,000. Transfers therefore account for net taxes of about $20,000,000. To the extent that such transfers may be made without subjecting the

> property transferred to the estate tax, the Government will lose a considerable amount of revenue. In view of the increased estate tax rates, it is probable also that taxpayers will be straining every effort to devise transfers which will permit them to retain control of their property during their lifetime and escape the imposition of estate taxes thereon. The proposed amendments are designed to plug up loop holes which now appear, so that taxpayers may not be successful in effecting tax avoidance."

This third stage of the statute was expressly made inapplicable to transfers prior to the date of the enactment of the 1936 Act, and the differentiation in the treatment of transfers before and of transfers after June 22, 1936, has been emphasized in Section 811 of the Code, set forth above at page 6. Whether or not in plugging up so-called loop holes as regards transfers after June 22, 1936, Congress has transcended the limits described in the opinion in the City Bank Farmers Trust Company case, *supra*, has apparently not yet been judicially decided.

At any rate, we are concerned with the proper construction of the statute, not in its first or third stage, but in its second stage, as it was in force between 1924 and 1936, a period of the creation of many trusts, in only a small proportion of which has the settlor since died. The estates of the settlors of such trusts, like the estate here, are entitled to the application of Section 302 (d) as originally enacted, without prejudice from the 1936 amendments.

Plainly the Circuit Court here was influenced by such amendments, relying on its understanding that Congress, as well as the Treasury, had interpreted the 1926 Act before amendment as covering a power in the decedent exercisable by him only as a trustee. This understanding is materially impaired by the consideration that the report of

the Ways and Means Committee, to which the Circuit Court refers, did not relate to the Revenue Bill of 1936, but to a separate bill which did not pass, and that the remark in the report to the effect that "to some extent it is believed this amendment is declaratory of existing law" does not specify which part of the amendment or at all amount to a statement of the intent of Congress in originally enacting Section 302 (d). Obviously this expression in the Committee's report was instigated by the Treasury Department, which in its regulations sought to make the 1936 statute retroactive in fact, although not in law. Prior to Regulations 80 (1937 edition) the regulations of the Treasury Department contain no such broad interpretation of Section 302 (d) in force prior to the 1936 amendments. See Regulations 70 (1929 edition), Article 19, and Regulations 80 (1934 edition), Article 20.

In the City Bank case (cited by the Circuit Court) the Court emphasized that the purpose of Congress in enacting Section 302 (d) was to prevent avoidance of the tax and that it could not arbitrarily ignore recognized rights to convey individual property. *Certainly the inclusion of a settlor as a trustee was a long recognized and normal concomitant of the creation of a trust, without any thought of tax avoidance, and in the present case no inference of a purpose of tax avoidance may be drawn from the record.* The long recognized distinction between a person in his individual capacity and in the capacity of trustee required more than the inexpressive language of the original 1926 Act to obliterate it. (*Cf. Becker* v. *St. Louis Union Trust Company, supra,* page 11.) In the Helmholz case the settlor was a beneficiary, and if the 1936 amendments be imputed to Section 302 (d) as it existed before them, then the statute was even more applicable to a beneficiary than to a trustee. It is noteworthy that the power was in the "then" bene-

ficiaries, excluding successor beneficiaries by appointment or otherwise under the terms of the trust. In the Poor case (cited by the Circuit Court), again disregarding the limited scope of the statute in the absence of the 1936 amendments and giving the language an unreasoning literal effect, the decedent at the date of her death did share in a power of amendment, although it existed in her fortuitously as a trustee and not in herself as settlor.

The Circuit Court also relied on *Reinecke* v. *Smith*, 289 U. S. 172, an income tax case under a different statute, which turned on whether or not a trustee as such was a beneficiary of the trust. The trust deed provided that the trust might be "modified or revoked at any time by an instrument in writing signed by Douglas Smith (the grantor) and either one of the other two trustees or their successors". This Court held that a trustee as such was not a beneficiary, saying in part:

> "Both words have a common and accepted meaning; the former signifies the person who holds title to the *res* and administers it for the benefit of others; the latter the *cestui que trust* who enjoys the advantages of such administration."

There the settlor as such, and not as a trustee or beneficiary, had the power specified by the statute. Whether or not he was a trustee had no significance.

We believe that enough has been said to show that serious and important questions of estate tax law are involved in the Terhune case. Rightly or wrongly the decision of the Circuit Court of Appeals came as a shock to lawyers concerned with trusts and estates. There are undoubtedly a great number of trusts created before 1936, which the trustees are empowered to modify or terminate. In many of these the settlor is one of the trustees or entitled to appoint

trustees. Each such situation, as the result of the Circuit Court's decision, presents a potential controversy as to whether or not Section 302 (d) is applicable. Regardless of the soundness of the decision of the Circuit Court, it will materially further the orderly administration of justice if the Court will in this case clarify the application and construction of Section 302 (d), which in its form before the 1936 amendments is still very much a live statute (I. R. C., Section 811, *supra*, page 6).

Conclusion

It is at least doubtful that to Section 302 (d) of the 1926 Act before amendment should be ascribed the enlarged meaning of the express language of the 1936 Act. That doubt must be resolved in favor of the taxpayer. *Cf. Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 348. It is respectfully submitted that the petition for a writ of certiorari herein should be granted.

HUGH SATTERLEE,
WM. R. GREEN, JR.,
Amici Curiae.